STATE PERCENT FUNDING FORMULA FOR THE UNIVERSITY EDUCATIONAL UNITS

STAFF REPORT TO PEPB SUB COMMITTEE

June 12, 2006

Why does the state funding formula appear to lead to an inevitable decline of the state percent share of total funding for the university educational units?

As part of the interim work plan, specifically Project #2 Alternative State Funding Models for Higher Education, at the February meeting of the PEPB, members requested that staff assemble and present at the June meeting a report that could explain the apparent formula trend that is leading the state percent share of funding downward each biennium, as displayed in the worksheet Historical Funding Educational Units Only: Montana University System Fiscal Years 1988-2007 (20 Years of History). This report is intended to provide that explanation to members of the PEPB.

Historically, the state percent share of funding for the university educational units is derived through a formula that looks at the ratio between state funding and the total revenue that funds the base year expenditures for the units. As with virtually all state agencies, each biennial budget starts with base year expenditures that establish the subsequent "base" level of funding for the next budget. So in the current 2007 biennium budget, the "base" from which the FY2006 and FY2007 budgets are built is the actual expenditures, as adjusted, for FY2004.

In funding each biennium budget for the university units, this base level of expenditures also drives the historic state percent share formula that determines the state funding level for Present Law Adjustments (PLA), those adjustments added to base funding in order to support "current service levels" (this includes **enrollment increases** and the level of state funding for the **pay plan** at the university units).

Therefore, to determine why the historical funding formula for the state percent share for the university units seems to be on an inevitable downward spiral, it is important to look at the progression of the funding sources that support the base year expenditures.

In the current 2007 biennium, which used FY2004 as the base expenditure level, the state percent share started at about 43 percent of those expenditures. Moving into the funding for the 2007 biennium present law adjustments and pay plan, therefore, the historical formula would have state funding support 43 percent of those present law adjustments, including the state pay plan.

To make this more understandable, lets look at an illustration (see graphic illustration on the next page) that starts with the FY04 expenditure base and converts this into easy to understand numbers, so that the 43 percent state share becomes $43 of state funding together with $57 of tuition revenue, which together provide 100 percent, or $100, to fund the entire FY04 expenditure base example.

Well, there are essentially three drivers within this formula each fiscal year that effectively pushes the state percent share downward each fiscal year and in each subsequent biennial budget. These three drivers are:
♦ Differences in present law definitions between the university units and state government, specifically there are present law cost increases within the nature of the "business" of university units that state government

does not contemplate in other agencies and does not fund under present law adjustments for the university units (see table below for details of present law adjustment factors and differences)
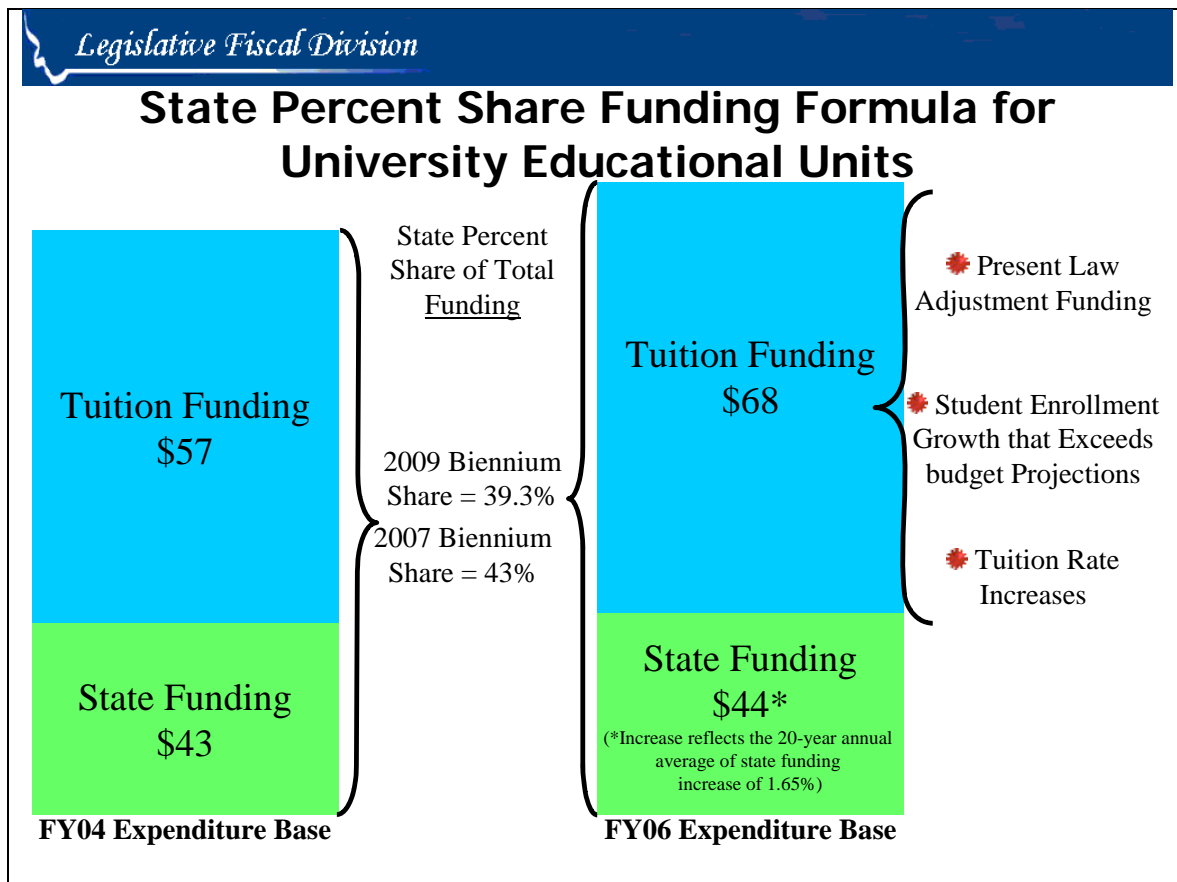
Present Law Adjustment Factors and Projected Rates Comparative between the Montana University System and State Government Budget (2007 and 2009 Biennia)			
University System		**State Government**	
Present Law Factor (PL)	Annual PL Rate/Total Projection (2009 Bien)	Annual PL Rate/Total Projection (2009 Bien)	Funding Status in HB2 (2007 Bien)
State Pay Plan	3.0%	To Be Determined	Yes
Health Ins.	10.0%	To Be Determined	Yes
Other Benes.	1.5%	To Be Determined	Yes
Emp. Merit/Mkt. Adjusts.	0.5%	To Be Determined	Not Funded
Vacancy Savings	3.0%	To Be Determined	Yes
Insurance (Tort Claims)	0.0%	To Be Determined	Yes
Other State Fixed Costs	4.0%	To Be Determined	Yes
IT Fixed Costs	6.0%	To Be Determined	Partial Funding
Library Acquisitions	7.0%	To Be Determined	Partial Funding
Utility Adjustments	20.0%	To Be Determined	Partial Funding
Contingency Costs	2.5%	To Be Determined	Not Funded
Other Operating Costs	2.5%	To Be Determined	Not Funded
Fee Waivers	6.0%	To Be Determined	Not Funded
Enrollment Growth	$3,566,827	To Be Determined	Yes
New Space O & M Costs	$1,227,635	To Be Determined	Yes
Faculty Promotion Pool	$834,224	To Be Determined	Not Funded
Faculty Termination Costs	$1,254,858	To Be Determined	Not Funded
CEO Pay Plan	$813,788	To Be Determined	New In 2009
State Percent Share Model:			
For Present Law Adjusts	80.6%**	To Be Determined	80.0%
For Pay Plan	42.2%	To Be Determined	39.0%

** Represents the percentage funding level for those PLA's that state government will fund. Overall, the percentage funding level for all PLA's is projected at 37.7%

Sources: OCHE System Summary Document (May 2006) and HB2/MBARS for 2007 legislative session

♦ Student enrollment growth that exceeds enrollment projections, which, regardless of tuition rates, generates new and additional tuition revenue, not matched by a state share, that is used to fund base year expenditures
♦ Tuition rate increases, beyond those which the legislature may anticipate in the budget, which generate new and additional revenue that is used to fund the base year expenditures (Note that there may be campus budget initiatives in some biennia that the universities, students and the Regents consider for funding only by tuition revenue and not with state funding)

Therefore, each year that these three drivers dump additional tuition revenue funding into the expenditure base, that original $43 of state funds plus adjustments going forward, which in FY2004 had represented 43 percent of the total funding, now represents a smaller percentage of the total in subsequent fiscal years. And the result is that, under this historical formula, the present law adjustments and pay plan in the subsequent budget will be funded at this new, lower state percent share level.

So in part as a result of this historic formula, through no apparent conscious public policy decision by the legislature about the state percent share, but through a series of built-in mathematical anomalies, the historic state percent share formula has moved downward each biennium since 1988.

For this reason, the legislature may want to consider an alternate state funding model or formula that introduces conscious legislative policy consideration and decision making about what that state percent share level should be in the state budget for the Montana University System.

Legislative Fiscal Division

State Percent Share Funding Formula for University Educational Units

State Percent Share of Total <u>Funding</u>

Tuition Funding
$57

2009 Biennium
Share = 39.3%

2007 Biennium
Share = 43%

State Funding
$43

FY04 Expenditure Base

Tuition Funding
$68

State Funding
$44*

(*Increase reflects the 20-year annual average of state funding increase of 1.65%)

FY06 Expenditure Base

✹ Present Law Adjustment Funding

✹ Student Enrollment Growth that Exceeds budget Projections

✹ Tuition Rate Increases

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